

Ikwezi Municipality

Audit Report

For the year ended 30 June 2014

REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON IKWEZI LOCAL MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the financial statements of the Ikwezi Local Municipality set out on pages 1 to 60, which comprise the statement of financial position as at 30 June 2014, the statements of financial performance, changes in net assets, cash flows and statement of comparison of budget and actual amounts for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2013 (Act No. 2 of 2013) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-General's responsibility

3. My responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the General Notice issued in terms thereof and International Standards on Auditing (ISA). Because of the matters described in the basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

Property, plant and equipment

4. I was unable to obtain sufficient appropriate audit evidence to confirm the balance of infrastructure assets, other assets, work in progress included within property, plant and equipment, depreciation, amortisation and the restatement of the prior year, as disclosed in note 28 to the financial statements, because the municipality could not provide a fixed asset register with sufficient detail of descriptions, locations, purchase prices and purchase dates supported by valid documentation. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustments to infrastructure assets, stated at R123,1 million (2013: R114,3 million), other assets stated at R4,4 million (2013: R3,8 million), depreciation and amortisation of R2,8 million and work in progress stated at R9,9 million in the financial statements was necessary. I was unable to obtain sufficient appropriate evidence to confirm the balance of land and buildings and the restatement of the prior year as disclosed in note 28 to the financial statements. Not all land and buildings, per the deed search, were recorded in the fixed asset register. I was unable to verify the balance by alternative means. Consequently I was unable to determine whether any adjustment to land and buildings stated at a cost of R2,1 million (2013: R2,1 million) in the financial statements was

necessary.

5. The municipality did not value all items of property, plant and equipment in accordance with *GRAP 17*, Property, plant and equipment. The municipality does not review the useful lives of property, plant and equipment and moveable assets recorded at R1 although they are still in use at the reporting date. Furthermore, the municipality did not depreciate items over reasonable useful lives. Consequently, property, plant and equipment and accumulated depreciation is overstated by R4,9 million (2013: R4,1 million), depreciation expense is understated by R2,8 million (2013: R917 913) and accumulated surplus is overstated by R2,1 million (2013: R3,2 million).
6. *GRAP 17*: Property, plant and equipment requires the preparers of financial statements to disclose land and buildings as separate classes of assets where they apply the cost model to land and buildings. Furthermore, *GRAP 17* requires the preparers of financial statements to classify items of property, plant and equipment into distinct categories that are representative of the characteristics of those items of property, plant and equipment. During the current and prior year the municipality applied the cost model to land and buildings but did not disclose land and buildings as separate classes of assets. Also, the municipality did not classify and separately disclose the various categories of property, plant and equipment. *GRAP 17*: Property, plant and equipment also requires entities to disclose impairments, of items of property, plant and the municipality has not disclosed the impairment of items of property, plant and equipment. Furthermore the municipality did not disclose the value of finance lease assets for the comparative figure.
7. In addition the municipality did not disclose sufficient information on *GRAP 21*: Impairment of non-cash generating assets, which requires the entity to disclose the criteria developed by the entity to distinguish non cash generating assets from cash generating assets and for each class of assets, the amount of impairment losses recognised in surplus or deficit during the period and the line item(s) of the statement in financial performance in which impairment losses are included, the amount of reversals of impairment losses recognised in surplus or deficit during the period and the line item(s) of the statement of financial performance in which those impairment losses are reversed.

Accumulated surplus

8. I was unable to obtain sufficient appropriate audit evidence to confirm the balance of accumulated surplus and the restatement of the prior year amount as disclosed in note 28 to the financial statements. The municipality did not have adequate systems in place to maintain records of all financial transactions. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustment to accumulated surplus stated at R107,9 million (2013: R109,5 million) in the financial statements was necessary. Furthermore, the municipality failed to disclose the difference between what was reported and what should have been reported in 2013 as a prior period adjustment in the Statement of changes in net assets.

Investment property

9. I was unable to obtain sufficient appropriate audit evidence to confirm the balance of investment property and the restatement of the prior year amount as disclosed in note 28 to the financial statements, as the municipality did not have a property management system in place for the identification and recognition of investment property. I was unable to confirm the balance by alternative means. Furthermore, not all investment properties, per the deed search, were recorded in the investment property register. I was unable to verify the balance by alternative means. Consequently I was unable to

determine whether any adjustment to investment property, stated at R43,7 million (2013: R43,7 million) in the financial statements was necessary.

10. The municipality did not value all items of investment property in accordance with *GRAP 16: Investment Property*. The municipality does not review the valuation of investment property according to the latest valuation roll. Consequently investment property and accumulated surplus is overstated by R82 699 (2013:R2,2 million).

Unspent conditional grants and receipts

11. I was unable to obtain sufficient appropriate audit evidence to confirm the balance of the unspent conditional grants and receipts and the restatement of the prior year amount as disclosed in note 28 to the financial statements, as the municipality did not have adequate systems in place to maintain records of unspent conditional grants and receipts. Furthermore, the sub-ledger did not reconcile to the financial statements. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustment to unspent conditional grants and receipts stated at R2,6 million (2013: R7,5 million) in the financial statements was necessary.
12. In terms of *GRAP 23: Revenue from non-exchange transactions*, where a municipality recognises an asset, as a result of a non-exchange transaction, it also recognises revenue equivalent to the amount of the asset measured in accordance with paragraph .40, unless it is also required to recognise a liability. The municipality did not correctly account for entries relating to of the recognition of conditional grants. Consequently, government grants and subsidies revenue is overstated and unspent conditional grants and receipts are understated by R410 040 (2013: R332 739). Additionally, there is a consequential impact on the surplus for the period and the accumulated surplus. Furthermore, the municipality did not account for grant expenditure in the correct period, consequentially general expenses is overstated by R2,5 million and government grants and subsidies revenue is overstated with R2,5 million. Additionally, there is a consequential impact on the surplus for the period and the accumulated surplus.
13. The municipality did not agree their figures to the underlying supporting documentation, consequentially, Repayment – National revenue fund is understated with R243 080 and the Unspent conditional grants and receipts is overstated with R243 080.

Receivables

14. I was unable to obtain sufficient appropriate evidence to confirm the balances and disclosure of trade and other receivables from exchange transactions, the provision for doubtful debts as disclosed in note 4 to the financial statements, the bad debt expense and the restatement of the prior year amount for trade receivables and other receivables from non-exchange transactions as disclosed in note 28 to the financial statements as the municipality did not have a receivables management system in place to maintain records and supporting documentation for the trade and other receivables from exchange transactions, the provision for doubtful debts and the bad debt expense. I was unable to confirm the balances by alternative means. Consequently I was unable to determine whether any adjustments to trade and other receivables from exchange transactions stated at R26,1 million (2013: R20,2 million), the provision for doubtful debts stated at R23 million (2013: R14,7 million) and the bad debt expense stated at R8,2 million (2013: R3,0 million) in the financial statements was necessary.

15. In the prior year I was unable to obtain sufficient appropriate evidence to confirm the balances and disclosure for other receivables from non-exchange transactions in note 3 to the financial statements as the municipality did not have a receivables management system in place to maintain records and supporting documentation of the other receivables from non-exchange transactions. I was unable to confirm the balances by alternative means. Consequently I was unable to determine whether any adjustments to other receivables from non-exchange transactions stated at R46 102 in the financial statements was necessary. My audit opinion on the financial statements for the period ended 30 June 2013 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures
16. *GRAP 104*: Financial instruments, requires entities to disclose information that would aid the users of the financial statements to understand the nature of the financial instruments of the entity as well as the risks that the financial instruments pose to the entity. The municipality failed to disclose the carrying amounts of each of the categories of financial instruments. The municipality did not disclose assets and liabilities at amortised cost in note 45.

Government grants and subsidies

17. I was unable to obtain sufficient appropriate audit evidence for government grants and subsidies as disclosed in note 18 and the restatement of the prior year figures as disclosed in note 28 to the financial statements as the municipality did not have adequate systems in place to maintain records and supporting documentation for revenue that reconciled to the financial statements. I was unable to confirm the government grants and subsidies by alternative means. Consequently I was unable to determine whether any adjustment relating to government grants and subsidies stated at R37 million (2013: R30,5 million) in the financial statements was necessary. Furthermore, sufficient information has not been disclosed in note 18 as to whether or not the conditions for the conditional grants have been satisfied.

Property rates

18. I was unable to obtain sufficient appropriate audit evidence for property rates disclosed in note 16 to the financial statements as the municipality did not have adequate systems in place to maintain records and supporting documentation for revenue that reconciled to the financial statements. I was unable to confirm the property rates by alternative means. Consequently I was unable to determine whether any adjustment relating to property rates stated at R1,6 million (2013: R1,4 million) in the financial statements was necessary.

Service charges

19. I was unable to obtain sufficient appropriate audit evidence for service charges disclosed in note 17 and the restatement of the prior year amount as disclosed in note 28 to the financial statements as the municipality did not have adequate systems in place to maintain records and supporting documentation for revenue that reconciled to the financial statements. I was unable to confirm the service charges by alternative means. Consequently I was unable to determine whether any adjustment relating to service charges stated at R10,6 million (2013: R10,1 million) in the financial statements was necessary.

20. In the prior year the municipality did not recognise electricity, refuse and sewerage revenue for certain consumers or did not recognise revenue at the correct tariff as required by *GRAP 9*. Revenue from exchange transactions. Consequently revenue from exchange transactions and trade and other receivables from exchange transactions are understated by R373 643. Additionally, there is a consequential impact on the surplus for the period and the accumulated surplus. My audit opinion on the financial statements for the period ended 30 June 2013 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

Interest received - internal

21. I was unable to obtain sufficient appropriate audit evidence for interest received - internal disclosed in note 19 to the financial statements as the municipality did not have adequate systems in place to maintain records and supporting documentation for revenue that reconciled to the financial statements. I was unable to confirm the interest received - internal by alternative means. Consequently I was unable to determine whether any adjustment relating to interest received - internal stated at R722 520 (2013: R608 881) in the financial statements was necessary.

Other income

22. I was unable to obtain sufficient appropriate audit evidence for other income disclosed in note 19 and the restatement of prior year figure as disclosed in note 28 to the financial statements as the municipality did not have adequate systems in place to maintain records and supporting documentation for revenue that reconciled to the financial statements. I was unable to confirm the other income by alternative means. Consequently I was unable to determine whether any adjustment relating to other income stated at R1 million (2013: R503 077) in the financial statements was necessary.

Property rates – penalties imposed

23. I was unable to obtain sufficient appropriate audit evidence for property rates – penalties imposed disclosed in note 19 to the financial statements as the municipality did not have adequate systems in place to maintain records and supporting documentation for revenue that reconciled to the financial statements. I was unable to confirm the property rates – penalties imposed by alternative means. Consequently I was unable to determine whether any adjustment relating to other property rates – penalties imposed at R231 287 in the financial statements was necessary.

Expenditure

24. I was unable to obtain sufficient appropriate evidence for general expenses and repairs and maintenance as the municipality did not have a proper expenditure management system in place to maintain records and supporting documentation for expenditure. I was unable to confirm general expenses and repairs and maintenance by alternative means. Consequently, I was unable to determine whether any adjustment relating to general expenses stated at R14,2 million (2013: R13,2 million) and repairs and maintenance stated at R1,9 million (2013: R1,6 million) in the financial statements was necessary.

25. I was unable to obtain sufficient appropriate audit evidence for the restatement of the corresponding figure for general expenses, personnel expenses, depreciation and amortisation, repairs and maintenance and bulk purchases as described in the financial statements. The restatement was made in order to rectify a prior year misstatement. I was unable to confirm the restatement by alternative means. Consequently I was unable to determine whether any further adjustment to the corresponding figures of general expenses stated at R13,2 million, personnel expenses stated at R17,7 million, depreciation and amortisation stated at R2,7 million, repairs and maintenance stated at R1,6 million and bulk purchases stated at R5,6 million in the financial statements was necessary.
26. The municipality did not correctly classify expenses between repairs and maintenance and general expenses. Consequently, repairs and maintenance is overstated by R147 365 and general expenses is understated by R147 365. The municipality did not correctly account for expenses in the correct period. Consequently, general expenses is overstated by R324 265 and accumulated surplus is overstated by R324 265. The municipality did not correctly classify expenses between general expenses and property, plant and equipment. Consequently, general expenses is overstated by R145 055 and property, plant and equipment is understated by R145 055. Additionally, there is a consequential impact on the surplus for the period and the accumulated surplus. The municipality did not have sufficient controls over the processing of expenditure from source documentation into the general ledger and as a result general expenses is overstated with at least R101 953.

VAT Payable

27. I was unable to obtain sufficient appropriate audit evidence to confirm the balance of the VAT payable and the restatement of the prior year amount as disclosed in note 28 to the financial statements as the municipality did not have an adequate system in place to maintain records and supporting documentation for the VAT reconciliation that reconciled to the financial statements. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustment to the VAT payable stated at R1,2 million (2013: R1,4 million) in the financial statements was necessary.
28. The municipality does not perform a VAT reasonability to ensure their VAT is within a reasonable range. As a result VAT payable is overstated with at least R82 602, other income is understated with at least R108 032 and general expenses is understated with at least R190 634.

Leave Accrual

29. I was unable to obtain sufficient appropriate audit evidence to confirm the balance of the leave accrual as the municipality did not have an adequate system in place to maintain records and supporting documentation for the leave accrual. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustment to the leave accrual stated at R1,6 million (2013: R1,4 million) in the financial statements was necessary.
30. The municipality did not use the correct salary scale in all instances and did not correctly apportion the leave days to calculate the accrual. As a result the leave accrual is overstated by at least R197 622 and personnel cost is overstated with at least R197 622.

Employee benefit obligations

31. The municipality did not place controls in place to ensure that all employees entitled to employee benefit obligations have been included in the account. Consequently employee benefit obligation is understated with at least R137 000 and personnel expenditure is understated with at least R137 000. Furthermore, the municipality did not do a proper review of the financial statements before submitting it for audit purposes. Consequently the disclosure of the experience adjustments on plan as per note 44.1 of the financial statements is understated with R255 000.

Personnel expenditure

32. I was unable to obtain enough audit evidence for personnel expenditure. The municipality did not have adequate systems in place to maintain records and supporting documentation for personnel costs that reconciled to the financial statements and was unable to provide supporting documentation for salary scales, deductions, acting allowances and wage payments. I was unable to confirm the personnel expenditure by alternative means. Consequently I was unable to determine whether any adjustment to personnel expenditure stated at R17,8 million (2013: R17,7 million) in the financial statements was necessary.

Trade and other payables from exchange transactions

33. In the prior year the municipality did not have a payables management system in place to compile a payables sub-ledger, retain supporting documentation and for the identification and recognition of liabilities for goods and services received but not yet paid for, which resulted in an understatement of trade and other payables from exchange transactions, general expenses and VAT receivable by at least R1,3 million, R1,1 million and R158 892 respectively. My audit opinion on the financial statements for the period ended 30 June 2013 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.
34. In the prior year I was unable to obtain sufficient appropriate audit evidence to confirm the balances and disclosure of trade and other payables from exchange transactions as disclosed in note 12 to the financial statements as well as payments made after year end. I was unable to confirm the balance or disclosure by alternative means. Consequently due to the lack of systems in place it was impracticable to determine the full extent of the understatement of trade and other payables from exchange transactions, therefore I was unable to determine whether any further adjustments to trade and other payables from exchange transactions stated at R15,3 million in the financial statements was necessary. My audit opinion on the financial statements for the period ended 30 June 2013 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.
35. I was unable to obtain sufficient appropriate audit evidence for the restatement of the corresponding figure for trade and other payables from exchange transactions. As described in note 28 to the financial statements, the restatement was made in order to rectify a prior year misstatement. I was unable to confirm the restatement by alternative means. Consequently I was unable to determine whether any adjustments to trade and other payables from exchange transactions corresponding figure stated at R15,3 million in the financial statements was necessary.

Cash and cash equivalents

36. In the prior year I was unable to obtain sufficient appropriate audit evidence to confirm the balance of cash and cash equivalents. The municipality did not have an adequate system in place to maintain records and supporting documentation for the bank reconciliation that reconciled to the financial statements. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustments to cash and cash equivalents stated at R41 087, and the bank overdraft stated at R897 117 in the financial statements was necessary. My audit opinion on the financial statements for the period ended 30 June 2013 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

Contingencies

37. The municipality does not have a system in place to ensure contingencies are complete. Furthermore they do not do an assessment whether a provision should be raised at year end when it is probable that an outflow of economic resources will occur and as a result there is a misclassification between raising a provision or making a contingency disclosure. Consequently provisions for legal fees are understated with at least R496 588.

Councillors' arrear consumer accounts

38. I was unable to obtain sufficient appropriate audit evidence to confirm compulsory disclosure in Note 41 to the financial statements as the municipality did not have an adequate system in place to maintain records and supporting documentation for compulsory disclosure. I was unable to confirm the disclosure by alternative means. Consequently, I was unable to determine whether any adjustments to compulsory disclosure in the financial statements were necessary.

Irregular expenditure

39. The municipality made payments in contravention of the supply chain management requirements, which were not included in irregular expenditure disclosure, resulting in irregular expenditure being understated by R3,3 million. Furthermore the municipality did not condone irregular expenditure in terms of Section 68 of the MFMA, consequently irregular expenditure is understated with a further R3,5 million. In addition, the municipality made personnel payments to staff members without having contracts or salary scale information in place. Due to the lack of systems in place it was impracticable to determine the full extent of the understatement of irregular expenditure. Consequently I was unable to determine whether any further adjustments to irregular expenditure stated at R1,9 million (2013: R9,5 million) in the financial statements was necessary.

Unauthorised expenditure

40. The municipality did not condone unauthorised expenditure in terms of Section 68 of the MFMA, consequently unauthorised expenditure is understated with R10,4 million. The municipality incorrectly included the balance of property, plant and equipment on note 34 of the financial statements and consequently unauthorised expenditure is overstated with R84,3 million. As a result of these misstatements unauthorised expenditure is overstated with R73,9 million.

41. In the prior year I was unable to determine whether any further adjustments to unauthorised expenditure stated at R10,4 million in the financial statements were necessary.

Capital Commitments

42. I was unable to obtain sufficient appropriate audit evidence for the disclosure of commitments as the municipality did not have a contract management system in place for the identification and recognition of contracted commitments. I was unable to confirm the commitments by alternative means. Consequently I was unable to determine whether any adjustment to the commitments stated at R3,7 million (2013: R2,8 million) in the financial statements was necessary.

Fruitless and wasteful expenditure

43. The municipality incurred expenditure in procurement and overpaid acting allowances that were not included in fruitless and wasteful expenditure, as disclosed in note 35 to the financial statements, resulting in fruitless and wasteful expenditure being understated by R464 297 million (2013: R 1 million). The municipality did not condone fruitless and wasteful expenditure in terms of section 68 of the MFMA, consequently fruitless and wasteful expenditure is understated by a further R213 168. Due to the lack of systems in place it was impracticable to determine the full extent of the understatement of fruitless and wasteful expenditure. Consequently I was unable to determine whether any further adjustments to fruitless and wasteful expenditure stated at R583 336 (2013: R213 168) in the financial statements was necessary.

Deviations from supply chain management regulations

44. The municipality did not include all deviations that occurred during the year in the disclosure of note 37. As a result the deviations are understated with at least R39 045. Due to the lack of systems in place it was impracticable to determine the full extent of the understatement of deviations from supply chain management regulations. Consequently I was unable to determine whether any further adjustments to deviation from supply chain management regulations stated at R3,2 million in the financial statements was necessary.

Material losses

45. I was unable to obtain sufficient appropriate audit evidence for material losses disclosed in note 39 to the financial statements as the municipality did not have adequate systems in place to maintain records and supporting documentation for revenue and expenditure that reconciled to the financial statements. I was unable to confirm the material losses by alternative means. Consequently I was unable to determine whether any adjustment relating to distribution losses of water of 5% (2013:5.6%) and relating to electricity of 48.9% (2013: 45.9%) in the financial statements was necessary.

Cash flow statement

46. *GRAP 2*: Cash flow statements, requires the presentation of a cash flow statement, summarising the entity's operating, investing and financing activities. The cash flow statement for the current and prior year could not be confirmed due to the limitations imposed by the lack of sufficient appropriate audit evidence as included in this report.

Budget information

47. *GRAP 24*: Presentation of budget information in financial statements, requires the presentation of a comparison between the budget and actual amounts. The budget comparison must be accompanied by explanations of material differences between the budget and actual amounts as well explanations of changes from the approved budget to the final budget. Difference were noted between the approved budget and the budget amounts disclosed in the AFS and the amount for fixed asset additions does not agree to the amount as disclosed in note 7 to the financial statements. In addition the municipality did not include explanations for all material variances.

Preparation of the financial statements

48. I was unable to obtain sufficient appropriate audit evidence that the accounting officer has fulfilled her responsibility for the preparation and fair presentation of the financial statements in accordance with GRAP, as written representations in this respect were not provided. I was also unable to obtain written representations from the accounting officer that I had been provided with all relevant information and access as agreed in terms of the audit engagement and that all transactions had been recorded and were reflected in the financial statements. I could not determine the effect of the lack of such representations on the financial position of the municipality at 30 June 2014 or the financial performance and cash flows for the year then ended.

Disclaimer of opinion

49. Because of the significance of the matters described in the basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on these financial statements.

Emphasis of matters

50. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Restatement of corresponding figures

51. As disclosed in note 28 to the financial statements, the corresponding figures for 30 June 2013 have been restated as a result of errors discovered during 30 June 2014 in the financial statements of Ikwezi Municipality at, and for the year ended, 30 June 2013.

Material losses/Impairments

52. As disclosed in note 4 to the financial statements, trade and other receivables from exchange transactions amount to approximately R26.1 million but have been impaired by an amount of approximately R22.5 million as it is unlikely that the municipality will recover the amount from the debtors.

Financial Sustainability

53. The financial statements indicate that the municipality's current liabilities exceeded its total current assets by approximately R22.8 million. These conditions indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to settle its accounts as they fall due, and therefore operate as a going concern. Note 46 to the financial statements, going concern, indicate that there are material uncertainties regarding the going concern assumption.

Significant Uncertainties

54. With reference to note 15 to the financial statements, the municipality has two active landfill site which were not licensed as required by the National Environmental Management: Waste Act, 2008 (Act No 59 of 2008).

Additional matters

55. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Conditional grant funds are not supported by liquid cash investments

56. As disclosed in note 14 to the financial statements, there is a conditional grant liability of approximately R2.6 million. However, the bank is in an overdraft position of approximately R 300 000 as disclosed in note 5 to the financial statements. This indicates that conditional grant funds are being used for other expenditures not in terms of the grant.

Unaudited Supplementary schedules

57. The supplementary information set out on pages 61 to 62 does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

Irregular expenditure

58. As disclosed in note 36 to the financial statements, the municipality have disclosed irregular expenditure of R 1.9 million for the year ended 30 June 2014. I was unable to obtain sufficient appropriate audit evidence to ascertain whether these goods/services were delivered to the municipality.

Unaudited disclosure notes

59. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with this legislation. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

Withdrawal from the audit engagement

60. Due to the limitation imposed on the scope of the audit by management, I have disclaimed my opinion on the financial statements. But for the legislated requirement to perform the audit of the municipality, I would have withdrawn from the engagement in terms of the ISAs.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

61. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings on the reported performance information against predetermined objectives for selected objectives presented in the annual performance report, non-compliance with legislation as well as internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

Predetermined objectives

62. The annual performance report was not presented for auditing and consequently my findings below are limited to the procedures performed on the strategic planning and performance management documents for the following selected objectives:

- Objective 1: To focus on the issues of economic potential and sustain our environment in pages 212 to 213
- Objective 2: To ensure and promote local economic competence and skills on page 216
- Objective 3: To improve existing infrastructure on pages 218 to 220
- Objective 4: To improve the provision of the basic needs on page 220

63. I assessed the information to determine whether the performance indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).

64. The material findings in respect of the selected objectives or are as follows:

Objective 1: To focus on the issues of economic potential and sustain our environment

Usefulness of performance information

Measurability of indicators

Performance indicators not well defined and verifiable

65. The FMPPI requires the following:

- Performance indicators must be well defined by having clear data definitions so that data can be collected consistently and is easy to understand and use. Performance indicators must also be verifiable.

66. The measurability of indicators could not be assessed due to a lack of proper systems and processes and formal standard operating procedures or documented system descriptions.

Objective 2: To ensure and promote local economic competence and skills

Usefulness of performance information

Measurability of indicators

Performance indicators not well defined and verifiable

67. The FMPPI requires the following:

- Performance indicators must be well defined by having clear data definitions so that data can be collected consistently and is easy to understand and use. Performance indicators must also be verifiable.

68. The measurability of indicators could not be assessed due to a lack of proper systems and processes and formal standard operating procedures or documented system descriptions.

Objective 3: To improve existing infrastructure

Usefulness of performance information

Measurability of indicators

Performance indicators not well defined and verifiable

69. The FMPPI requires the following:

- Performance indicators must be well defined by having clear data definitions so that data can be collected consistently and is easy to understand and use. Performance indicators must also be verifiable.

70. The measurability of indicators could not be assessed due to a lack of proper systems and processes and formal standard operating procedures or documented system descriptions.

Objective 4: To improve the provision of the basic needs

Usefulness of performance information

Measurability of indicators

Performance indicators not well defined and verifiable

71. The FMPPI requires the following:

- Performance indicators must be well defined by having clear data definitions so that data can be collected consistently and is easy to understand and use. Performance indicators must also be verifiable.

72. The measurability of indicators could not be assessed due to a lack of proper systems and processes and formal standard operating procedures or documented system descriptions.

Strategic and performance management

73. Sufficient appropriate audit evidence could not be obtained to assess whether the local community was consulted by means of a municipal wide structure for community participation/through a forum that enhances community participation in drafting and implementing the Integrated development plan (IDP), as required by section 28 of the MSA and Municipal planning and performance management regulation 15(1)(a)(i).

74. Sufficient appropriate audit evidence could not be obtained to assess whether the local community was afforded the opportunity to comment on the final draft of the integrated development plan(IDP) before adoption, as required by section 42 of the MSA and Municipal planning and performance management regulation 9, 13(1), 13(4)(c) and 15(3).

75. The municipality did not conduct its affairs in a manner which was consistent with its integrated development plan, as required by section 36 of the MSA, section 21(2)(a) of the MFMA and Municipal planning and performance management regulation 6.
76. Sufficient appropriate audit evidence could not be obtained to assess whether the integrated development plan(IDP) was not reviewed based on the assessment of its performance measurements and/or changing circumstances , as required by section 34 of the MSA and Municipal planning and performance management regulation 3 and 11.
77. Sufficient appropriate audit evidence could not be obtained to assess whether the municipality did establish a performance management system, as required by section 38(a) of the Municipal Systems Act.
78. Key performance indicators, including input, output and outcome indicators, in respect of each of the development priorities and objectives were not set out in the IDP, as required by section 41(1)(a) of the MSA and the Municipal planning and performance management regulation 1 and 9(1)(a).
79. Sufficient appropriate audit evidence could not be obtained to assess whether measurable performance targets for the financial year with regard to each of the development priorities or objectives and key performance indicators were set in the IDP, as required by section 41(1)(b) of the MSA and the Municipal planning and performance management regulations 12(1) and 12(2)(e).
80. The annual performance report for the financial year under review was not prepared, as required by section 46 of the MSA and section 121(3)(c) of the MFMA.
81. Sufficient appropriate audit evidence could not be obtained to assess whether the annual performance agreements for the municipal manager and all senior managers are linked to the measurable performance objectives approved with the budget and to the service delivery budget implementation plan as required in terms of section 53(1)(c)(iii) of the MFMA and section 57(1)(b) of the MSA.
82. The performance management system and related controls were not in place as it did not describe and represent the processes of performance planning, monitoring, measurement, review, reporting, improvement and how it is conducted, organised and managed, including determining the roles of the different role-players, as required by sections 38 of the MSA and regulation 7 of the Municipal planning and performance management regulations.

Annual Report and Annual Financial statements

83. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of non-current assets and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records were provided subsequently, but the uncorrected material misstatements resulted in the financial statements receiving a disclaimer audit opinion.
84. The 2012/13 annual report was not tabled in the municipal council within seven months after the end of the financial year, as required by section 127(2) of the MFMA.
85. A written explanation was not submitted to council setting out the reasons for the delay in the tabling of the 2012/13 annual report in the council, as required by section 127(3) and 133(1)(a) of the MFMA.

86. Oversight report, containing comments on the annual report, was not adopted by council within two months from the date on which the 2012/13 annual report was tabled, as required by section 129(1) of the MFMA.

Internal Audit

87. An internal audit unit was not established, as required by section 165(1) of the MFMA.

Audit committee

88. An audit committee was not in place, as required by section 166(1) of the MFMA for the entire period under review.
89. A performance audit committee was not in place and the audit committee was not used to fulfil the performance audit committee function, as required by Municipal planning and performance management regulation 14(2)(a).
90. The audit committee did not advise the council and the accounting officer on matters relating to internal financial control and internal audits, risk management, accounting policies, effective governance, performance management and performance evaluation as required by section 166(2)(a) of the MFMA.
91. The audit committee did not advise the council and the accounting officer on matters relating to the adequacy, reliability and accuracy of financial reporting and information, as required by section 166(2)(a)(iv) of the MFMA.
92. The audit committee did not advise the council and the accounting officer on matters relating to compliance with legislation, as required by section 166(2)(a)(vii) of the MFMA.
93. The audit committee did not respond to the council on the issues raised in the audit reports of the AGSA, as required by section 166(2)(c) of the MFMA.
94. The audit committee did not review the municipality's performance management system and did not make recommendations to the council, as required by Municipal planning and performance management regulation 14(4)(a)(ii).
95. The audit committee did not submit, at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by Municipal planning and performance management regulation 14(4)(a)(iii).
96. The audit committee was not constituted, in the manner required by section 166(4)(a) MFMA as the following requirements were not adhered to:
- The audit committee has not met at least four times a year, as required by section 166(4)(b) of the MFMA.

Budgets

97. Sufficient appropriate audit evidence could not be obtained that the total unforeseen and unavoidable expenditure incurred exceeded 5% of own revenue, in contravention of Municipal Budget and Reporting Regulation 72.
98. Sufficient appropriate audit evidence could not be obtained that expenditure was approved as unforeseen and unavoidable which was considered by the council but not

included in the approved annual budget and is in contravention of Municipal Budget and Reporting Regulation 71(2).

99. Expenditure was not incurred in accordance with the approved budget which is in contravention of section 15 of the MFMA.

Revenue management

100. A credit control and debt collection policy was not implemented, as required by section 96(b) of the MSA and section 62(1)(f)(iii) of MFMA.
101. An adequate management, accounting and information system which accounts for revenue and debtors was not in place, as required by section 64(2)(e) and 97(h) of the MFMA.
102. An effective system of internal control for debtors / revenue was not in place, as required by section 64(2)(f) of the MFMA.
103. Revenue due to the municipality was not calculated on a monthly basis, as required by section 64(2)(b) of the MFMA.
104. Accounts for municipal tax and charges for municipal services were not prepared on a monthly, as required by section 64(2)(c) of the MFMA.
105. Interest was not charged on all accounts in arrears, as required by section 64(2)(g) of the Municipal Finance and Management Act.

Expenditure management

106. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
107. Payments/ withdrawals were made from the municipality's bank account without the approval of the chief financial officer, as required by section 11(1) of the MFMA.
108. An effective system of expenditure control, including procedures for the approval, authorisation, withdrawal and payment of funds, was not in place, as required by section 65(2)(a) of the MFMA.
109. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred, as required by section 65(2)(b) of the MFMA.
110. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Asset management

111. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.
112. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.

113. The municipality did not establish an investment policy that was adopted by council, as required by section 13(2) of the MFMA and Municipal investment regulation 3(1)(a).

Liability management

114. An effective system of internal control for liabilities (including a liability register) was not in place, as required by section 63(2)(c) of the MFMA.
115. An adequate management, accounting and information system which accounts for liabilities was not in place, as required by section 63(2) (a) of the MFMA.

Conditional grants and transfers

116. The municipality did not evaluate its performance in respect of programmes or functions funded by the Municipal Systems Improvement Grant allocation, as required by section 12(5) of the Division of Revenue Act (DoRA).
117. The municipality did not evaluate its performance in respect of programmes or functions funded by the Municipal Infrastructure Grant allocation, as required by section 12(5) of the DoRA.
118. The municipality did not evaluate its performance in respect of programmes or functions funded by the Local Government Finance Management Grant allocation, as required by section 12(5) of the DoRA.

Procurement and contract management

119. Sufficient appropriate audit evidence could not be obtained that all contracts and quotations were awarded in accordance with the legislative requirements and a procurement process which is fair, equitable, transparent and competitive, as there is a clear lack of proper record keeping at the municipality.
120. Sufficient appropriate audit evidence could not be obtained that goods and services with a transaction value of below R200 000 were procured by means of obtaining the required price quotations, as required by SCM regulation 17(a) & (c).
121. Quotations were accepted from prospective providers who are not registered on the list of accredited prospective providers and do not meet the listing requirements prescribed by the SCM policy in contravention of SCM regulation 16(b) and 17(b).
122. Sufficient appropriate audit evidence could not be obtained that goods and services of a transaction value above R500 000 were procured by means of inviting competitive bids and that deviations approved by the accounting officer were only if it was impractical to invite competitive bids, as required by SCM regulation and 36(1).
123. Sufficient appropriate audit evidence could not be obtained that bid specifications for procurement of goods and services through competitive bids were drafted in an unbiased manner that allowed all potential suppliers to offer their goods or services, as per required by SCM regulation 27(2)(a).
124. Sufficient appropriate audit evidence could not be obtained that bid specifications were drafted by bid specification committees which were composed of one or more officials of the municipality as required by SCM regulation 27(3).

125. Sufficient appropriate audit evidence could not be obtained that bids were evaluated by bid evaluation committees which were composed of officials from the departments requiring the goods or services and at least one SCM practitioner of the municipality as required by SCM regulation 28(2).
126. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded to bidders based on points given for criteria that were stipulated in the original invitation for bidding and quotations, as required by SCM Regulations 21(b) and 28(1) (a) and Preferential Procurement Regulations.
127. Sufficient appropriate audit evidence could not be obtained that bid adjudication was always done by committees which were composed in accordance with SCM regulation 29(2).
128. Awards were made to bidders other than those recommended by the bid evaluation committee without ratification by the accounting officer, as required by SCM regulation 29(5) (b).
129. Sufficient appropriate audit evidence could not be obtained that the preference point system was applied in all procurement of goods and services above R30 000 as required by section 2(a) of the Preferential Procurement Policy Framework Act and SCM regulation 28(1)(a).
130. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded to suppliers based on preference points that were allocated and calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act and its regulations.
131. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded to bidders that scored the highest points in the evaluation process, as required by of section 2(1)(f) of Preferential Procurement Policy Framework Act.
132. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded only to bidders who submitted a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
133. Construction projects were not always registered with the Construction Industry Development Board (CIDB), as required by section 22 of the CIDB Act and CIDB regulation 18.
134. The prospective providers list for procuring goods and services through quotations was not updated at least quarterly to include new suppliers that qualify for listing, and prospective providers were not invited to apply for such listing at least once a year as per the requirements of SCM regulation 14(1)(a)(ii) and 14(2).
135. The municipality did not implement an SCM policy as required by section 111 of the MFMA.

Human Resource (HR) Compliance

136. The acting head of the administration department was appointed for a period of more than three months without the approval by the MEC for local government in contravention of section 56(1)(c) of the MSA.

137. The annual report of the municipality did not reflect information on compliance with prescribed minimum competencies as required by the Regulations on Minimum Competency Levels reg14(2)(b)
138. Sufficient appropriate audit evidence could not be obtained to verify whether the municipality did not submit a report on compliance with prescribed competency levels to the National Treasury and relevant provincial treasury as required by the Regulations on Minimum Competency Levels reg14(2)(a).
139. An approved staff establishment was not in place, as required by section 66(1)(a) of the Municipal Systems Act.
140. Sufficient appropriate audit evidence could not be obtained whether senior managers have been dismissed for financial misconduct in a previous position and re-appointed before the expiry of 10 years in contravention of section 57A of the MFMA.

Consequence management

141. The condonation of irregular expenditure was not approved by the appropriate relevant authority, as required by section 1 and 170 of the MFMA.
142. Irregular expenditure was not always recovered from the liable person, as required by section 32(2) of the MFMA.
143. Irregular expenditure was written-off as irrecoverable without being certified by council as irrecoverable, in contravention of section 32(2)(a)(ii) of the MFMA.
144. Authorisation of unauthorised expenditure was not done through an adjustment budget, as required by section 32(2)(a)(i) of the Municipal Financial Management Act.
145. Disciplinary proceedings were not instituted by the council where the report of independent investigators confirmed the financial misconduct by a senior manager, as required by Disciplinary regulations for senior managers 5(6).
146. Unauthorised, irregular and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.

Internal control

147. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for disclaimer of opinion, the findings on the annual report performance report and the findings on compliance with laws and regulations included in this report.

Leadership

148. Ineffective leadership and poor oversight responsibility continues to prevail as evidenced by the numerous findings that have been repeated in the current year regarding the financial statements, performance reporting, compliance and internal controls. There is a complete disregard of accountability and commitment to improve significant internal control deficiencies which does not protect and enhance the best interests of the municipality as this lays the entity open to fraud.

149. The delegation process was not implemented adequately to ensure the delegates were held accountable for their responsibilities. The extensive vacancies during a major part of the year resulted in a lack of segregation of duties resulting in a significant breakdown in internal controls, significant audit findings, as well as susceptibility to fraud.
150. Management did not have policies and procedures in place for a number of processes, the most significant being the financial statement close process, performance reporting and a formally approved information technology (IT) security policy.
151. Actions plans were not monitored to address the risks relating to the achievement of complete and accurate financial and performance reporting supported by easily accessible supporting documentation.

Financial and performance management

152. Management did not implement an effective records management system to ensure that supporting documentation was filed timeously and methodically, accessible only to authorised personnel and easily accessible and available to support accurate and complete financial and performance information for audit purposes. The financial statements submitted for audit were materially misstated and the annual performance report was not submitted for audit.
153. The extensive vacancies and lack of adequately skilled staff during the year and the absence of communication and delegation of authority resulted in the breakdown of controls around daily and monthly processing, authorizations, reconciliations, reviews, filing and retaining information and knowledge to understand the financial framework and performance management requirements.
154. Management did not sufficiently and effectively implement and execute monitoring controls to ensure compliance with its laws and regulations. This contributed to repeated as well as newly identified non-compliance findings in the current year.

Governance

155. Management did not ensure that their audit committee and internal audit functioned throughout the year to provide an oversight role. Due to the lack of governance in the period, and due to no risk assessment being performed by management, it appears impossible to have addresses any risks identified during the period.

Auditor-General
East London

28 November 2014



AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence